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# AUDITOR INDEPENDENCE: A STUDY OF THE PERCEPTIONS OF SENIOR AUDITORS

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**Abstract**

Auditor Independence: A Study of the Perceptions of Senior Auditors

The trustworthiness of an audit report rests on the perception of auditor independence. However, several factors can affect those perceptions, ultimately affecting market confidence. This study aims at providing a deep understanding of auditors' perceptions of auditor independence, particularly analysing whether and how their perceptions are affected either by the provision of non-audit services, competition, the size and tenure of the audit firm or the client's financial condition. Qualitative research was held through semi-structured interviews. Both the provision of non-audit services and tenure have generated great consensus amongst interviewees. Rotation and litigation exposure were mainly perceived as enhancement factors.

**Keywords** Auditing, Auditor independence, Perceptions

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## I. Introduction

Following the financial crisis, the European Commission reformed the audit market (Quick & Schmidt, 2018). Ever since, several measures have been implemented in an attempt to achieve financial stability, with greater attention being devoted to the importance of audits in stabilizing the financial system (European Commission, 2010; Quick & Schmidt, 2018). In addition, audits play an important role on the considerations of investors and other stakeholders, as they provide an opinion on the reliability of entities' financial statements (ibid). Therefore, by strengthening public trust, audits ultimately contribute to the orderly running of markets (European Commission, n.d.).

Nevertheless, an audit report is only valuable as long as it comprises trustworthy information (Quick & Warming-Rasmussen, 2005). Actually, the relevance of audited information depends on the belief that auditors are independent, otherwise the audit opinion will be meaningless (Quick & Warming-Rasmussen, 2005; Gul, 1989). Since the perception of auditor independence is widely accepted to increase auditor credibility (Dopuch et al., 2003), independence is required to be "the unshakeable bedrock of the audit environment" (European Commission, 2018, p. 3). However, several factors have long been suggested to affect users' perceptions of auditor independence (Gul, 1989).

Therefore, the purpose of this study is to examine how senior auditors perceive auditors' independence, particularly analysing whether and how these perceptions are affected by a set of variables. These variables comprise the provision of non-audit services, competition, the size and tenure of the audit firm and the client's financial condition. Similarly, enhancement factors are also addressed.

The following section reviews the main issues believed to impact the perceptions of auditor independence. Subsequently, methodology is described, followed by an analysis of the research's main findings. Final conclusions are then presented.

## II. Literature Review

### *Auditor Independence*

Auditor independence can be defined as the ability to make unbiased judgements and audit decisions, free from other parties' pressures and influences (Alleyne et al., 2006; Bazerman et al., 1997). Although some authors suggest objectivity as an equivalent concept of independence (DeFond et al., 2002), Bartlett (1993, p. 55) simplifies this notion by excluding "nonspecific terms" as integrity or objectivity and defining independence as "an unbiased mental attitude in making decisions about audit work and financial reporting".

Usually, two related dimensions of auditor independence are distinguished, namely, independence in fact and independence in appearance (Alleyne et al., 2006; Dopuch et al., 2004; Beattie et al., 1999). While the former is an unbiased state of mind that allows the auditor to withstand influences that compromise professional judgement, the latter relates to the avoidance of circumstances that would lead informed third parties to reasonably conclude that the ability of the auditor to make unbiased judgments had been compromised (AICPA, 2014).

Since independence in fact is not directly observable, Dopuch et al., (2003) highlight the impossibility to regulate an individual's mindset in a timely manner. Instead, regulators must rely on the appearance dimension, outlining the importance of public perception (Dopuch et al., 2004). Accordingly, Shockley (1981, p. 785) states that "credibility depends ultimately on the perception rather than on the fact of independence" and Holland and Lane (2012) reinforce this line of reasoning by recognising auditor independence as a key attribute to establish confidence in information provided, and eventually, to accomplish audit quality. Moreover, DeAngelo (1981) argues that audit quality is the joint probability that an auditor will both discover a misstatement in the accounting system (conditional on perceived auditor's competence) and report the known material error (conditional on perceived auditor's independence) (Quick & Schmidt, 2018; Bell et al., 2015).

*Threats and Enhancement Factors*

Prior literature has long sought to identify the factors that may affect users' perceptions of auditor independence. Nevertheless, it often focuses on potential threats to independence, that is, challenges and sources of pressure believed to impair auditor independence, as opposed to factors that enhance public perceptions (Alleyne et al., 2006; Umar & Anandarajan, 2004). According to Simunic (1984, p. 679), "any situation which increases the probability that an auditor will not truthfully report the results of his audit investigation can be viewed as a threat to independence". Moreover, some assert that auditors cannot always be independent and objective, given the relationship they must maintain with their clients in order to obtain appropriate evidence and future revenue (Umar & Anandarajan, 2004).

Commonly addressed factors believed to impact auditors' independence include the degree of competition within the audit market, client size and the provision of non-audit services (NAS). Other discussed factors comprise, for instance, tenure, the client's financial condition and opinion shopping opportunities (Alleyne et al., 2006; Beattie et al., 1999; Knapp, 1985; Shockley, 1981).

Nonetheless, several factors are argued to counterbalance threats and to improve auditor independence and objectivity as, for instance, reputation concerns and litigation exposure (Lim & Tan, 2008). Additionally, regulatory factors such as the existence of audit committees, control over the appointment and remuneration of auditors, effective discipline of companies and auditors, and strong enforcement of standards, are argued to promote perceived auditor independence (Alleyne et al., 2006; Beattie et al., 1999).

*Non-audit Services (NAS)*

Among the previously identified factors, the provision of NAS has been one of the most controversial (Gul, 1989). In fact, there is no consensus in literature on whether rendering non-audit services influence auditors' ability to objectively evaluate financial statements (Bartlett, 1993). Although some studies suggest a negative effect on auditors' independence (Quick & Warming-Rasmussen, 2005; Beattie et al., 1999; Shockley, 1981), others found NAS to positively impact perceived independence (Gul, 1989). Furthermore, other researchers show no evidence or inconclusive results (DeFond et al., 2002; Knapp, 1985).

The provision of non-audit services to clients raise two main concerns. One relates to a strengthened economic bond between auditor and auditee, that is, to an increased financial reliance on the client: as an unfavourable opinion can possibly compromise not only audit relationships, but non-audit relationships as well, a fear of potentially losing increased revenue may impair auditor independence (Lim & Tan, 2008; Alleyne et al., 2006; DeFond et al., 2002; Bazerman et al., 1997). Additionally, the provision of such services, as consulting, can bias auditors' professional judgement as they must review their own work. Actually, auditors' may be motivated to ignore or conceal errors related to advisory services so to protect other services reputation (Quick & Warming-Rasmussen, 2005; Simunic, 1984; Shockley, 1981).

On the other hand, proponents of NAS rendering argue that the provision of both audit and non-audit services may improve auditor independence (Dopuch et al., 2004). One possible reasoning follows Goldman and Barlev's (1974) view which suggests that offering non-routine services enhances auditor singularity and value to the client, hence improving auditor's ability to resist client pressure and, consequently, to remain independent (Gul, 1989; Shockley, 1981). Additionally, since both functions require information about the very same company, knowledge spillovers[1] may emerge from the joint provision of services, hence increasing audit efficiency and quality (Bell et al., 2015; Beattie et al., 1999; Simunic, 1984). Further, supporters enhance that advisory services are typically rendered by separate departments (Quick & Warming-Rasmussen, 2005; Gul, 1989), and that clients additionally benefit from cost

[1] Benefits arising from interdependencies or interactions between joint provision of services (Simunic, 1984).

reductions as search and transaction costs should be reduced when acquiring NAS from the auditor (Simunic, 1984).

Notwithstanding, Quick and Warming-Rasmussen (2005) postulate that "a lack of independence can neither be justified by efficiency arguments nor by the chance of increased effectiveness in the auditing and consulting areas" (p. 153). Further, the authors declare that "improved consulting services are primarily beneficial for the auditor and the client whereas a lack of independence harms the interests of external addressees" (p. 154).

*Competition*

An intensively competitive market is usually claimed to increase auditors' economic dependence[2] on clients as they can easily obtain services from an alternative company (Beattie et al., 1999; Gul, 1989). Regardless of the reasons, either simply fees minimization or search for a more acquiescent opinion, perceived independence will be at stake as clients' incentives and opportunities for replacement increase (Shockley, 1981). Additionally, competitive environments often lead accounting firms to engage in low-balling, that is to say, to accept unprofitable discounted fees in the early years, so to become the new auditor (Quick & Schmidt, 2018; Bazerman et al., 1997). However, by lowering fees below audit cost there is an exacerbated pressure to compromise their independence, hence retaining clients and subsequent payoffs from the investment (Quick & Schmidt, 2018; Bazerman et al., 1997).

Although empirical results typically support the above-mentioned insights (Knapp, 1985; Shockley, 1981), Gul (1989) found environment competition to strength perceived auditor independence. One possible explanation refers that as competition increases, auditors attempt to create a favourable public image, resembled to impartiality, so to retain their clientele (ibid).

[2] Economic dependence can be thought of as an inducement for auditors to impair their independence and report favourably in order to maintain clients (Reynolds & Francis, 2001).

Finally, alongside audit market competition, auditors also come across accounting firms' strict expectations, and failure to meet those can often lead to withdrawal (Bazerman et al., 1997). As a result, auditors must handle both dimensions of competitiveness, which may negatively impact their independence by allocating considerable attention to short-term revenue (ibid).

*Audit Firm Size*

Earlier research suggests that the size of the audit firm may impact perceived auditor independence. When compared to larger-sized audit firms, Shockley (1981) found smaller firms to be perceived as less independent (Umar & Anandarajan, 2004). Gul (1989) delivered consistent results.

As larger firms are expected to maintain a larger clientele, it assures that no particular client is a considerable source of firm revenue because the client's related fees constitute a smaller fraction of the company's total revenue (Gul, 1989; Shockley, 1981). However, for smaller-sized firms, a single client can cause significant damages. Actually, considering substantial loss of revenue, negative outcomes, as personnel reductions or lower compensations, may follow (Reynolds & Francis, 2001). Additionally, specific characteristics intrinsic to small firms' audit practices, as the propensity to develop more personalised services or closer relationships with clients, may induce smaller firms towards a more indulgent and favourable report (Reynolds & Francis, 2001; Gul, 1989; Shockley, 1981). Therefore, given the size of its portfolio of clients, larger firms are perceived as more independent (Reynolds & Francis, 2001).

Moreover, following an uncovered lack of independence, the auditor's reputation can be damaged, meaning that the broader the number of clients, the greater the risk of losing additional clients' revenue (Quick & Warming-Rasmussen, 2005). Hence, a superior number of clients will serve as a warranty against misconducts, and consequently, as an incentive to audit independence and quality (ibid). According to DeAngelo (1981, p. 184), “the larger the auditor as measured by number of clients, the less incentive the auditor has to behave opportunistically and the higher the perceived quality of the audit”.

*Tenure*

Besides the above-mentioned factors, audit tenure has also been discussed as having a potential impact on auditor independence. In fact, some argue that a lengthy association between auditor and client lessens independence (Beattie et al., 1999). This assertion is usually explained through the notion that a long audit tenure leads the accounting firm to closely relate to its client’s management interests, hence relying on their accounting practices and consequently, losing scepticism (Quick & Schmidt, 2018; Shockley, 1981). Furthermore, after a lengthy association, a truly independent stand becomes difficult to take as the auditor becomes complacent and depends more on previous work, hence lowering his efforts and disregarding rigorous audit procedures (ibid).

On the other hand, opponents of the preceding viewpoint consider mandatory auditor rotation as detrimental to independence, i.e., that extended relationships may actually improve auditor independence (Quick & Schmidt, 2018). Moreover, opponents argue that through audit repetition, and a subsequent improved understanding of client’s operations and processes, mature firms can easily detect accounting misstatements, thus providing a more efficient and economical service, when compared to new auditors (Quick & Schmidt, 2018; Shockley, 1981). In addition, newly acquired auditors are expected to lack firm-specific knowledge and heavily rely on management information during initial years (Quick & Schmidt, 2018). As a result, clients are anticipated to perceive mature accounting firms as more valuable, hence intensifying auditors’ ability to resist management pressure and to remain independent (Quick & Schmidt, 2018; Shockley, 1981).

As auditors of a recently acquired firm must handle significant knowledge accumulation in a short period of time, Bell et al. (2015) find that first-year audits are more often classified as substandard audits (Knapp, 1991). Nevertheless, their findings suggest a significant improvement in audit quality afterwards, indicating that recent audit relationships may involve a considerable learning curve, which is consistent with auditor's knowledge accumulation. However, their results also corroborate a decline in audit quality as tenure becomes very long.

*Financial Condition*

Knapp (1985) found auditee's financial condition to negatively influence auditor's ability to withstand management pressure (Beattie et al., 1999). According to the author, the healthier a client's financial condition the lower the risk of legal exposure. Hence, the accounting firm may be less encouraged to withstand management pressure, increasing the client's perceived ability to attain its ideal outcome (Knapp, 1985). Actually, given a client's robust financial condition, the chance of an auditor being held responsible for a controversial decision is remote, thus impairing audit firm's perceived independence (ibid). Conversely, when the client's financial condition is poor, the audit outcome is unlikely to correspond to client's preferences, as the audit firm fears an increased legal exposure (Gul, 1989).

Nonetheless, Gul (1989) found client's financial condition to insignificantly affect subjects' perceptions, reasoning that subjects possibly lack awareness that auditor's independence could be impaired, the stronger the client's financial condition.

*Opinion Shopping*

Opinion shopping is usually understood as the search for an auditor willing to compromise independence and sustain a client's accounting procedure in order to fulfil intended reporting objectives (Lu, 2006). Even though some auditor replacements follow sound reasons, others may simply happen with the aim of finding a suitable audit opinion (ibid).

Lennox's (2000) research deduces two main findings: first, auditor switches happen more frequently after clients receive modified opinions, and second, auditor replacement increases the prospects of a change in audit opinion. Therefore, these conclusions suggest that clients effectively engage in opinion shopping practices (ibid). Furthermore, opinion shopping and resulting threats to discharge auditors may impair auditor independence, causing material misstatements to deliberately occur (Lu, 2006). Although opinion shopping may be perceived to negatively impact auditor independence, and subsequently, auditor quality, Lu (2006) shows inconsistent results, i.e., that neither is impaired by potential dismissals or opinion shopping.

In order to mitigate opinion shopping, debate has mostly concentrated on mandatory auditor rotation as opposed to mandatory auditor retention (ibid).

*Auditor Rotation*

Auditor rotation has been discussed as a means of enhancing auditor independence (Daniels & Booker, 2011). Essentially, by restricting the number of consecutive years an audit firm is allowed to assess an auditee's financial statements, regulators expect to reduce the economic bond between the two, hence decreasing the possible impairment of auditor independence (Quick & Schmidt, 2018; Daniels & Booker, 2011). Additionally, the recently selected auditor is expected to employ a "fresh perspective" to auditee's financial reporting and to be encouraged to reveal possible irregularities of the previous audit firm (Quick & Schmidt, 2018). Furthermore, this approach could be helpful to avoid negative effects arising from lengthy auditor tenure as, for instance, complacency, reliance on previous work, lack of rigor, and reliance on clients' integrity and accounting practices (ibid).

However, an AICPA study found audit failures to be more likely during an auditor's initial years auditing a specific company, thus sustaining that auditor rotation can intensify the possibility of audit failures, as newly assigned auditors possibly lack sufficient understanding of the client's business, which is crucial to identify accounting errors (Daniels & Booker, 2011).

Besides, if the investment cannot be offset within the restricted tenure, the auditor's willingness to invest in client-specific knowledge can decrease (Quick & Schmidt, 2018).

Earlier research primarily suggests that auditor rotation induces improved auditor independence perceptions. Quick and Schmidt (2018) found that a lenghty tenure may compromise independence, as auditors are perceived to become complacent and depend more on prior audits, resulting in lower effort and rigor. Nonetheless, their results do not enhance the importance of client-specific knowledge for perceived audit quality. Likewise, Daniels and Booker (2011) found audit firms' rotation policies to increase loan officers' perceptions of auditor independence, despite not impacting their perceptions of audit quality.

*Auditor Retention*

Whereas auditor rotation rests on replacements, auditor retention aims at preventing audit firms' substitution for a determined period of time (Lu, 2006).

Although rotating auditors potentially enhance auditor independence perceptions, there is no guarantee that the client will not intimidate the audit firm by threating it with a possible discharge (Quick & Schmidt, 2018). In fact, by fearing dismissal before the rotation period ends, companies can compromise their independence (ibid). As a result, the mandatory retention of an auditor within an explicit length of time ensures protection against management pressures, thus enhancing auditor independence (ibid). Likewise, some support mandatory auditor retention in order to lessen opinion shopping opportunities (Lu, 2006).

Nonetheless, in a mandatory retention setting, auditors may become excessively confident insofar as it concerns their position. Actually, as the client must retain the auditor for a certain length of time, audit firms have economic incentives to decrease their efforts (Quick & Schmidt, 2018). Furthermore, if the rotation period is lengthier than the retention period, auditors have additional economic incentives to impair their independence, given the opportunity to be re-assigned by the auditee (ibid).

*Joint Audits*

Joint audits can be described as the shared performance of audit work by two different audit firms that jointly sign the audit report (Deng et al., 2014).

Several joint audits related characteristics have been appointed as potentially improving perceived auditor independence. First, as the audit is performed by two different firms, audit fees must be shared amongst them, expectedly reducing the economic bonding it exists in a single auditor setting (Quick & Schmidt, 2018). Additionally, it is easily acceptable that two auditors are more prone to withstand management pressure, hence increasing the chances of providing an impartial opinion (ibid). Furthermore, an improved perception of independence follows the "four-eyes principle" and related review of the other auditor's work (ibid). Lastly, if one of the firms is replaced, joint audit settings also mitigate the newly appointed firm's lack of client-specific knowledge in the initial years of the engagement (ibid).

On the other hand, joints audits can negatively influence auditor independence perceptions, as cooperative work raises the opportunities for "free-riding" (Quick & Schmidt, 2018). Under this circumstance, one of the auditors can attempt to take advantage of the other firm's work, by shirking its responsibilities and reducing its own effort (ibid). In addition, it may not be very efficient to collaborate if two different sized firms attempt to complete the same amount of work (Deng et al., 2014). Specifically, given the better expertise of the bigger firm, the smaller one is naturally expected to take longer to finish the task (ibid).

## III. Methodology

This study aims at providing a deeper understanding of auditors' perceptions of auditor independence, as well as the reasons behind such insights. Therefore, a qualitative research was conducted given its explanatory character which, according to Ryan (2002, p. 144), "attempt[s] to explain the reasons for observed accounting practices", being suitable to "understand and explain [...], rather than to produce generalizations" (ibid, p. 144).

In order to guarantee both resembled questions were asked and the flexibility to explore new ideas (Ryan, 2002), semi-structured interviews were conducted using an interview script (Appendix A). The questions were developed in order to understand whether previously discussed factors are perceived by auditors to impact independence, and if so, how would those materialize. Furthermore, the script comprised nine questions, which were further reduced to eight: as the interviews phase advanced, questions five and six turn out to merge.

Auditors were contacted through personal networking, although only one was personally known. Altogether, six auditors (one assistant, two seniors, two managers and one partner) were interviewed (two face-to-face and four by telephone), between October and November 2018. Of those, five either belong or belonged to 'Big 4' companies, and one currently belongs to a medium-size audit company. Table I presents further information regarding interviewees and the gathering of qualitative data.

Table I: Interviews and Interviewees Data

| | **Date** | **Via** | **Duration** | **Function** | **Company** |
|---|---|---|---|---|---|
| **Interview 1** | 30th Oct. | Telephone | 15 mins. | Assistant | Big 4 |
| **Interview 2** | 31st Oct. | Face-to-face | 35 mins. | Manager | Deloitte |
| **Interview 3** | 31st Oct. | Face-to-face | 40 mins. | Manager | Medium |
| **Interview 4** | 2nd Nov. | Telephone | 10 mins. | Senior | PwC |
| **Interview 5** | 13th Nov. | Telephone | 10 mins. | Senior | PwC |
| **Interview 6** | 14th Nov. | Telephone | 15 mins. | Partner | KPMG |

Every interview was recorded and subsequently transcribed, resulting in nearly 27 pages of data (Appendix B). Interviews were then compiled and read several times, so that patterns could be found by meaningfully dissect and combine information (Miles & Huberman, 1994). At last, data was reflected upon and findings connected to previous literature (ibid).

## IV. Empirical Study

Auditor independence can be referred to as the ability to make unbiased judgements, free from other parties' influences (Bazerman et al., 1997). In this regard, interviewee 1 conceptualizes it as the ability to *"issue any opinion not influenced by future developments, behaviours or any type of opinion"*. Further, interviewee 6 states that independence is not to have *"interests in the entities we audit [...] and interests can be monetary interests, can be personal, can be knowing someone in core functions in those entities"*.

Alternatively, as stated by DeFond et al. (2002, p. 1250), "auditor independence is often defined as the probability that the auditor will report a discovered breach in the financial reports". Within this framework, interviewee 2 refers that a lack of independence is a matter of omission, further explaining:

> *[...] independence it exists, i.e., I do my job, no one tells me not to do this or that, I do it and I have evidence (...) the question of independence lies in the omission in the opinion, that is, I do not issue an opinion based on all the facts that I have, because there are facts that I have no interest in issuing at this moment, so I omit.*

Despite being a controversial factor among researchers (Gul, 1989; Shockley, 1981), interviewees manly perceived the provision of NAS as detrimental to auditor's independence. In fact, some respondents are concerned that a conflict of interests may exist when services are provided by the same entity, as the firm can take advantage and time the sale of its services. Even though proponents argue that services are usually rendered in separate departments (Quick & Warming-Rasmussen, 2005), interviewee 1 highlights that it is still the same company providing them:

> *Although it seems that there are two companies, one consulting and one auditing, in practice and in everyday life we are talking about the same company, the same people who share the same workplace with a common interest, and that is business [...] there is almost a conflict of interests when it comes to doing business, through the planned sale of products and services.*

Accordingly, interviewee 2 explains that the auditor will take the opportunity to emphasize client's weaknesses, later recommending it to contract consulting services:

> *The auditor will analyse the company in a holistic way, that is, see the company as a whole […] and knowing that his company also provides consulting services, will express a need, i.e., will make the company feel that there is a need to improve in certain areas.*

Additionally, this conflict is further exacerbated as auditors have to review their own work (Quick & Warming-Rasmussen, 2005; Simunic, 1984; Shockley, 1981). Therefore, respondents manifested concerns as to auditors' ability to remain independent when auditing their companies: given that their professional judgment can be biased, auditors may hide errors related to other services so to protect the reputation of those (ibid). In this regard, interviewees 3 and 4, respectively, suggest:

> *[…] imagine there is restructuring consulting of the client and then any conflict is detected by the audit, and it was the same company that said to do so […] there will be a conflict. Perhaps, the [audit] opinion of the same company […] will not be impartial.*

> *If there is a material misstatement due to professional incompetence, to a poorly provided service, there may be a tendency to protect, since it is the same company.*

Notwithstanding, interviewee 6 has a slightly different position considering that, nowadays, the provision of NAS barely influences independence, and sustaining that *"in Portugal, the maximum that can be provided of services is, normally, 30% in relation to audit services, as such, 30% has no influence"*. However, this interviewee also enhances that, in the past, the discrepancy that could exist between services could lead the auditor to face more pressure as there was a strengthened economic bond:

> *In the past, when I could have a client in which auditing was 20 thousand and consulting was 200 thousand there could be more of a pressure […] there is always more pressure when we depend on a non-audit remuneration.*

Auditors' economic dependence on clients is also argued to increase as competition increases: since in competitive markets clients can easily obtain services from an alternative company, auditors can compromise independence so to retain subsequent payoffs (Beattie et al., 1999; Gul, 1989; Shockley, 1981). Interviewee 2 clarifies:

> *From the moment it is a business and the client has a large relative weight in the company's sales volume, and knowing that there are other competitors that can enter and are anxious to enter, it stands to reason that competition is one of the limiting factors of independence.*

Furthermore, the search for a more acquiescent opinion is simplified as clients' incentives and opportunities for replacement expand (Shockley, 1981). In this respect, interviewee 5 explains how competitive environments can either cause an auditor to compromise independence or foster opinion shopping practices:

> *Competition wants to enter, and the client is not happy with the year's audit. The auditor may turn a blind eye to something so that the client does not change to competition… Sometimes even the client may want to change to competition, so that competition turns a blind eye to certain situations.*

On the other hand, interviewee 6 dismisses an impact on independence, although highlighting how competitive markets can threaten audit quality:

> *[…] if they enter into a price war is bad, because it is not possible in face of new audit requirements, new standards, a series of additional procedures that have to be done […] it is not possible to carry out a good quality audit.*

Besides the above-mentioned factors, size has also been a subject of debate in literature. Researchers usually suggest that larger firms are perceived to be more independent than smaller firms: the former often holds a broader set of clients, assuring that no individual client is a considerable source of revenue (Quick & Warming-Rasmussen, 2005; Gul, 1989; Shockley, 1981). As a result, a particular client is not considered as essential to a large audit firm as it is to a small firm. Interviewees 4 and 5 share this view, correspondingly suggesting:

> *I think smaller companies are more prone to, perhaps, try to protect their position […] by wanting to keep the client and all, the work itself may not be done with quality or even independently.*
>
> *[…] small companies […] perhaps will not want to lose [an important client] due to issues related to opinion issuance… Can lead them to circumventing some situations so not to lose the client.*

Moreover, intrinsic characteristics to smaller firms, as the propensity to deliver more personalized services or to engage in closer relationships with clients, can induce a lack of independence (Gul, 1989; Shockley, 1981). Despite considering smaller firms more independent than large audit firms, interviewee 2 does not neglect the previous line of reasoning, enhancing: *"In smaller companies there is the risk of proximity, i.e., between partner and client, and that is a big risk because they are often friends"*. Also sustaining that smaller firms are more independent, interviewee 3 emphasizes: *"financial scandals were in large companies. As noted, there was no impartiality, no independence"*.

Conversely to previous analysed factors, auditor rotation has been discussed as a means of enhancing auditor independence (Daniels & Booker, 2011). In fact, when questioned about tenure's potential impact on auditor independence, subjects mostly perceived rotation as a suitable enhancement factor. Interviewees 1 and 2 assert that rotation detaches auditor and client, allowing for a greater incentive to express an independent opinion. Further, a newly selected auditor is expected to both apply a "fresh perspective" to the auditing process and to reveal possible irregularities of the previous audit firm, hence avoiding negative effects arising from a lengthy tenure, such as complacency and reliance on previous work (Quick & Schmidt, 2018). In this regard, some respondents state that the employment of a new perspective will enable to disrupt dependency and to prevent repetitive errors from occurring. Interviewees 1 and 4, respectively, sustain:

> *Many times it is necessary to have other people looking at the same thing in order to have a different perspective on the issues and eventually disrupt a potential […] dependency between the client and the auditor […] if there are shorter terms, this connection ultimately fades away: from the moment I know I will not be able to further continue with a client, I have a greater incentive to provide a more independent opinion.*

> *[…] the reason to change […] is really not to allow repetitive errors and bring a new perspective, and even if there is a lack of independence, break with that lack of independence.*

However, recently assigned auditors can lack sufficient knowledge of the client's business, which is critical to identify accounting misstatements (Daniels & Booker, 2011). Moreover, if the investment cannot be offset within the limited tenure, the auditor's disposition to invest in client-specific knowledge can decrease (Quick & Schmidt, 2018). Accordingly, interviewee 6 recognizes both the initial absence of sufficient knowledge, and the investment required to provide the newly assigned auditor with sufficient understanding of the client's business:

> *With audit firm rotation there is an additional cost to both auditors and companies, because companies will have to explain everything again when a new auditor comes, and the new auditor is always, in the first, second years, in very large institutions, a big investment, so, the auditor is assigned to a client without knowing anything […] Knows public information, but does not know anything else.*

Despite rotation's potential as an enhancement factor, there is no guarantee that the client will not intimidate the auditor with a possible discharge before the rotation period ends (Quick & Schmidt, 2018). Therefore, as audit firms can compromise their independence by fearing dismissal, mandatory retention is suggested as a means to ensure protection against management pressures (ibid). Correspondingly, interviewee 2 highlights:

> *[…] if there is no retention […] [the auditor] knows he can leave every year. He may have a single term of five years, but knows that if he does not express […] [a particular] opinion, he can leave after one year, so he is always constrained in his opinion.*

Additionally, as auditors' dismissal threats can also arise from opinion shopping practices, some support mandatory retention so to lessen this kind of opportunities (Lu, 2006; Lennox, 2000). Interviewee 4 exemplifies:

> *[A client] used to work with a small auditor that did not persisted much with certain aspects, suddenly gets a big company with greater experience, or another kind of tests, whatever the reason, that starts to find some errors. That can never be a reason to change […] To guarantee service's quality, and that the reason to change is a proper reason, and not simply because the auditor is being much more annoying than the other, I think it is good to have retention.*

Similarly, some joint audits' characteristics, as the "four-eyes principle" and the review of the other auditor's work, have been suggested as improving audit opinions' impartiality (Quick & Schmidt, 2018). In accordance, interviewee 5 perceives an improved independence, as auditing *"would not be confined to methodologies from the same company"*. Although assuming *"[a joint audit] brings neither gains nor losses"*, interviewee 4 further recognizes *"It brings two viewpoints"*.

Conversely, interviewee 3 questions the joint application of methods and cooperative work's efficiency, considering that *"where two work policies are joint, two mentalities, two different entities"* it would not work, justifying "*I do not know a single auditor who speaks well of another auditor's work, I do not see an auditor reading another's opinion and saying "Good job!"*.

Additionally, interviewee 6 perceives *"no great advantage"* in joint audits as *"[the auditors] will not be doing the same thing, they will end up dividing tasks"*. Similarly to interviewee 3, the interviewee further acknowledges interpersonal relationships as an additional constraint, exemplifying:

> *Parmalat case happened exactly because there were several auditors involved, so the communication between them was not fantastic. When we have large groups in which some are here, and others are there, communication turns out not to be as good as if it was always the same auditor, the same company.*

Although not establishing a direct connection between an auditee's financial condition and an auditor's independence (Beattie et al., 1999; Knapp, 1985), some interviewees perceived a higher risk of legal exposure - associated with poor financial condition (Knapp, 1985) - as likely to enhance auditors' independence. In this regard, interviewee 2 states that *"[if] the company is subject to huge legal regulation […] the auditor is much more careful […] because the auditor is more exposed"*. Moreover, and further mentioning reputation concerns, which may arise from litigation exposure, interviewees 1 and 4, respectively, suggest:

> *It can affect in the positive sense […] a greater likelihood of facing legal issues in the future can lead to a greater independence and transparency in the auditor's work, due to the very consequences that arise from legal exposure. At the end of the day we are always talking about a brand reputation issue to the market.*

> *[…] if there are legal issues, the ability to remain independent is even greater, I think it increases, because the auditor's risk is higher, the auditor has his company's name and his own to defend […] in that case independence increases.*

## V. Conclusion

This study shed light on how auditors perceive auditor independence, clarifying and providing a deeper understanding of auditors' insights on a set of variables, which have long been discussed to impact independence. Both, the provision of NAS and the tenure of the audit firm have generated great consensus among interviewees. These factors were mainly perceived to negatively impact independence. Regarding tenure, auditors instinctively mentioned rotation as an enhancement factor. Litigation exposure was also perceived to improve independence.

Because of the study's qualitative character, no statistical generalizations can be made out of it. Besides, along with a small sample size, the study attempted to analyse and cover several factors, which may have contributed not to extensively address all topics. Nonetheless, the selected method was aligned with the purpose of the research, which can further be extended either to exploit other factors or the perceptions of different subjects.

Additionally, the unavailability of audit companies to cooperate with the investigation has proven to be a challenge. Hence, as data gathering relied on personal connections, several limitations followed. First, as a few interviewees were no longer auditors, some answers may not reflect recent audit modifications, as respondents may not be aware of existing Portuguese legislation. Therefore, some bias may arise when considering results within a national context. Actually, as the study was meant to provide a broader perspective, a Portuguese sample may present itself a limitation, as auditors' perceptions can be influenced by, among other factors, specific professional standards.

Furthermore, not all respondents were senior auditors as previously anticipated: the study turn out to complement perspectives of professionals both at different career stages and of different companies. In this regard, it would also be interesting to investigate whether auditors' perceptions of independence would differ in accordance with their functions or between small and medium-sized enterprises and 'Big 4' companies.

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## VII. Appendices

*Appendix A: Interview Script*

1. Briefly, what does it mean to you to be independent in auditing?
2. Do you think the provision of non-audit services, as for instance, consulting services, can influence auditor independence? How?
3. When it comes to competition, in what way do you believe it can affect independence?
4. In comparison to small firms, do you perceive big audit firms as more independent? Why do you think is that?
5. What is your opinion towards lengthy audit tenure? In what sense is tenure good or bad?
6. How do you feel towards auditor rotation? Do you think it can improve independence?
7. What about auditor retention? Do you think it can influence independence?
8. In the event of a joint audit, what would you expect regarding independence?
9. Can you establish a connection between a client’s financial condition and the ability of the respective auditor to remain independent?

*Appendix B: Interviews*

**Interview 1**

1. Being independent in auditing means to be able to issue any opinion not influenced by future developments, behaviours or any type of opinion (that may be independent).
2. Yes, I think it can, insofar as we are talking about the same company. Although it seems that there are two companies, one consulting and one auditing, in practice and in everyday life we are talking about the same company, the same people who share the same workplace with a common interest, and that is business. So, when there is this conjunction of situations, I think there is almost a conflict of interests when it comes to doing business (through the planned sale of products and services).
3. Yes, eventually I think it can exist here some conflict. The more competitive the environment, the higher the need to retain a client and, possibly, to compromise independence, due to certain pressures.
4. I do not have an opinion on that, I have never worked in a small company, so I end up not realizing how small audit companies work. (Do you think large companies can have some features that makes them more independent?) More independent? Honestly, I do not think so.
5. I am in favour of shorter mandates, that is, of not having the same auditors for a long time. Many times, it is necessary to have other people looking at the same thing in order to have a different perspective on the issues and eventually disrupt a potential conflict of interests and dependency between the client and the auditor: there can often be a more promiscuous relationship here that can lead to an impartial opinion. I think that if there are shorter terms, this connection ultimately fades away: from the moment I know I will not be able to further continue with a client, I have a greater incentive to provide a more independent opinion.
6. I am in favour, following the previous logic.

7. I think that it does not affect independence, when I speak of independence I am always speaking at a higher hierarchical level, so here we are talking about ... audit (where I did) technical work and execution of tasks, I do not think that independence is affected, because that is not where the big decisions are made.
8. I would anticipate, perhaps, more independence and more transparency in the review of the subjects concerned and in the issue of an opinion.
9. I cannot get a sense of that connection, about the financial condition of the client to retain the auditor, or the auditor being less independent for a large client, is not it? I cannot establish a direct connection between those two. (And between the likelihood of facing legal issues, i.e., do you think a greater likelihood of facing legal issues can influence independence?) I think, I guess. It can affect in the positive sense, therefore, a greater likelihood of facing legal issues in the future can lead to a greater independence and transparency in the auditor's work, due to the very consequences that arise from legal exposure. At the end of the day we are always talking about a brand reputation issue to the market.

**Interview 2**

1. We have to define independence, isn't it? And to be independent is to express an opinion freely on the basis of audit evidence, that is, under evidenced facts, being able to express your opinion based on those facts and not having external misrepresentations that will constrain your opinion, that is independence, which should be underpinned in auditing. Independence is sometimes called into question by several factors. The auditor-client relationship. When the auditor audits the client is limited in his action because he will express an opinion that will call into question his client's functioning, will lose his client. This happened, for instance, in BES and other cases where, when the client's portfolio is big, imagine 40% of a company's sales volume, that company will do everything not to lose

that client, so it is constrained in its action, and its independence is at stake. The question now is: there is auditor's individual independence and there is audit firm's independence. When the auditor does his work, he must report all facts to the several existing hierarchies, they should not conceal and must express it; who then expresses an official opinion is the one that can filter it. An example of a chain: an assistant is dependent on a senior, i.e., the senior guides the assistant's work and will often get information from what he was developing; monitors the assistant's work. If the assistant hides information, the opinion is distorted. The assistant should report all facts, who should then filter it or not is the senior auditor; the senior will have to evaluate in each moment of his action if that work that was developed is sufficient, is necessary, is relevant or not to his opinion; without external filters, i.e., if it is sufficient to support an opinion, why? Then the senior will report that work to the manager and the manager will only develop, establish with him a limited set of points, will not see all the work. What I mean by this is that if in this chain each one of them ceases to be independent and covers some information, even though one of them actually wants to be independent, he will no longer be, because he is lacking information. And this always limits the work of an auditor. The partner is the one who signs, the decision is always his. And why is there sometimes a loss of independence? Because the report is discussed with management before issuing, it is discussed with the client. There is a limitation, i.e., we will discuss the "weaknesses" with the client, and the client may say "no, wait, we will…", that is, there must be a "negotiation relationship" with the costumer. Independence is always questioned from the moment there is a client relationship, i.e., there is a business relationship; from the moment auditing is a matter of business, even though independence is on paper, it is withdrawn in practice, i.e., it is lost. It does not mean that it is lost in its all, there are principles, there are limits, there are red lines… And it is no coincidence that you see some scandals in which the auditors were conniving, because for a long time, there are always indications that are noticed: if the auditor does not express that opinion is hiding it, is missing a whole value chain (…) the several stakeholders, i.e., its investors, I am considering that I am investing in a particular asset that is worth a certain value when in practice it is not worth that value, so I was deceived. Why? Because I am relying on an opinion that I consider valid and independent and it has been lost, there is the case of Enron, WorldCom, Parmalat, BES. BES is a paradigmatic case of it. Independence is always an interesting word to put in the report, if you notice says there "an opinion expressed (…) independently", and it is done independently, but it can be omitted, it is more by omission than by the fact that no opinion is given. What I mean by this is that independence it exists, i.e., I do my job, no one tells me not to do this or that, I do it and I have evidence, I have evidence, or I will seek evidence. The question of independence lies in the omission in the opinion, that is, I do not issue an opinion based on all the facts that I have, because there are facts that I have no interest in issuing at this moment, so I omit. What I am saying is that when I give an opinion in a report, imagine, I will express a reservation, maybe I should have another one, but I did not express it, so it is an omission, but I have it in my work, maybe I have sufficient elements to express that opinion, but I did not. So, I have independence at work; I "lose" that independence by omission in issuing an opinion. That is why we often have reports to management and reports to the outside. I think that the lack of independence is often more because of omission in the opinion than because of the elaboration of the work itself: we did the work, but we could not to express an opinion about what we saw. That is why we work very much with the concept of materiality. The concept of materiality is what we consider at some point in time, but it is not important and does not call into question the expression of the accounts. There are valid criteria and in the United States there was a lot of discussion in court about the concept of materiality because although being considered by the auditors it was not issued an opinion about that and took the company into bankruptcy later on, so auditors' defence was that the treaty was inferior to materiality's value and was not itself object of opinion. The court (…) was "but are there criteria, objectives for the calculation of materiality?", that is, is it the same amongst auditors, who defines those parameters, is the auditor individually, is the company where he works or is a set of international experts that defines these values? There are deadlines but essentially the concept of materiality is internally defined by each company and then each of the auditors, in this case managers and seniors, adjust to each of the entities they are auditing using their professional judgment. There is materiality concept and then there is a statistical concept which is the confidence interval: when we issue an opinion, we safeguard by saying that it only has a confidence level of 95%, (…), there is room for manoeuvre to both sides, either by the omission of what we cannot handle, or by the omission of what we do not express opinion.

2. There is an underlying principle of business which is going-concern principle which means timelessness: a company, when it opens, is timeless its lifetime. That is a basic principle that underlies auditors' work, i.e., an auditor tends to express an opinion in order to ensure, or at least, if he thinks that principle does not exist, to express an opinion about that principle, saying that the activity of the company (…) Consulting, in practice, is the definition of strategic plans, either (…) from the definition of what the company's processes are, or from a future perspective. Imagine the definition of that strategy will put the company into question, i.e. (…) it will be verified that it called into question. What is the auditor's role from the moment his company also defined that strategy? This is a small example. And then where is independence lost? The auditor opens weaknesses in his work, raising the need to contract other services. What do I mean by this? The auditor will analyse the company in a holistic way, that is, see the company as a whole, and often study its control environment among other things, and knowing that his company also provides

consulting services, will express a need, i.e., will make the company feel that there is a need to improve in certain areas. And who is going to handle it? The auditors will say “ah, there is…”, through recommendations. Express the weaknesses and make recommendations. Often these recommendations, although not expressed externally, i.e., in terms of official opinion because it does not affect the (accounts), but it affects the company’s organization and could be maximized in terms of costs or income, what is done? Makes room for the company to hire consulting services and who is going to do them? Who is in the front line? (…) Yes, regularly. From the moment you are manager you have to get customers, business volume. We manage portfolios and portfolios have to be maximized, that is why I say that when there is a customer relationship, the question of independence by omission is concerned.

3. Of course. Like what I said earlier. From the moment it is a business and the client has a large relative weight in the company’s sales volume, and knowing that there are other competitors that can enter and are anxious to enter, it stands to reason that competition is one of the limiting factors of independence, that is, in the normal sectors (…) that there is competition in auditing, which is a very specific job and it is, should be of credibility of the information to the outside world, to all stakeholders. Once there is competition and the company needs to survive through the company-customer relationship, the competition limits in terms of price; so to not lose, there is omission in the opinion.
4. No, Big 4 are less independent. They are less independent because they cover multiple business areas. Big 4 are those that are always looking for other business fields besides auditing. Who provides consulting? Essentially, Big 4. In smaller companies there is the risk of proximity, i.e., between partner and client, and that is a big risk because they are often friends. While in multinationals is from a business perspective, in small companies there is the risk of proximity between human relations.

5. Independence only existed when auditors were appointed by an independent entity, that is, like Banco de Portugal, like CMVM, in which they have a list of auditors and (…). They tried to improve independence through rotation. There are several measures introduced through a European directive that helps and heads in the right direction of improving auditors' opinion, namely, their independence, which is a matter of rotation. Initially, it started by the rotation between partners, that is, between those who sign. It could be within the same company, but the partner had to be different (…) there I thought independence was residual. The last approach is that every seven years, especially in listed companies, there must be rotation and there, it helps. Although some independence can be gain in this way, it can be lost by not officially separating the businesses of multinational companies, that is, consulting, auditing… That is, audit companies could not do any other service, only auditing. Rotation helps to improve independence because I know that in seven years I will have to leave. I am an apologist for the single mandate, that is, imagine five years without being able to be changed and after five years I have to leave and for two terms, in the next ten years, I cannot audit that company. (That is, you are in favour of rotation, but also of retention?) Given that it is a single mandate, which implies rotation, I am not attached, and it is a single mandate without possibility (i.e., also retention) I am not stuck to client-auditor relationship, I am more impartial to express an opinion.
6. (But at the same time the client has to retain it for a period of time) It is required. (Do you think there is any positive aspect also to independence?) Of course, totally, that is the focal point. Because if there is no retention, he knows he can leave every year. He may have a single term of five years, but knows that if he does not express an opinion, he can leave after one year, so he is always constrained in his opinion. That is why I say that the appointment should be a single mandate, with retention, appointed by an independent entity and not the company. The company would pay the independent entity the fees and the

independent entity would pay the audit service. There was a European Union directive in this regard, but it did not go forward.

7. For instance, I had Polis Program, Polis Program was about reordering cities and seafront, where we had audit firms and we were auditors, that is, we worked together on the opinion. (How do you think it can influence independence, do you think it is positive or negative) No, it is more independent because you cannot say one thing when the other says something else, because both issue a report, it is not the same report, both issue a report. So, if one says something and the other says it is wrong, then entities will have to call them “what’s going on?” It forces, ah, only if both are in (…) then it is fraud. (Do you think there is a downside?) There is a negative side to companies, it is more expensive, everything turns out to be expensive, we have to consider financial capacity and to what extent we should go with joint audits, whether it is for the whole universe of companies, or what kind of companies? And you say, ah, but who has audits is limited, it is only from a certain amount that it is mandatory. Yes, but it is different to talk about a company that sells 3 million in which the margin is 2%, because it is not only by business volume, today we talk a lot about business volume but for me what matters is what generates in terms of margin, because if I sell and then I earns 2% or 1% (…) I am not generating value, or companies that sell 50, 100 or 200 million, are totally different things.
8. I said behind that the auditor’s work is to assess something that is the going-concern principle. When we are talking about the financial situation there are two sides: one has to do with the economic perspective and the other with the financial perspective, they are different. The financial perspective has to do with treasury management and then it must be considered in an economic cycle, that is, the company’s activity, and when we are evaluating the going-concern principle, the auditor has to be careful to understand whether it is a financial problem, i.e., short-term, in which the company is not being able to receive

what has already produced, and there is a cash flow problem and it is necessary to evaluate the quality of its assets to verify if it is a good quality asset, and it is only a cash flow problem, or, if coupled with the treasury problem also has an asset quality problem (…) in bank, that had to create impairments, why? Because assets value dropped significantly, automatically, it changed all its ratios, it had to be capital injection. They are different. The auditor, when considering the financial relationship and the auditor's opinion, must be aware of these two things, why? Because an opinion referring that going concern principle is concerned is indicating to stakeholders that the company can go into insolvency, and it may not be true: the company may have economic capacity, without having sufficient financial capacity ate the moment to support… And specially to investors, imagine, I am issuing an opinion questioning the going-concern principle… A banking institution, to renew loans, always asks for an auditor opinion. (If the client has a healthier financial condition, do you think the auditor is more or less independent) I do not see independence like that. (What about the risk of legal exposure and independence) I think I am going to reverse the question. An auditor's independence is not seen by the degree of economic maturity, that is, whether it is healthy or not, but by the type of work, by the type of company the auditor will audit, imagine the company is subject to huge legal regulation, for instance, environmental issues, the auditor is much more careful. That is, it is not about the economic situation, but (…) because the auditor is more exposed, independence is also often due to the exposure that will have (Reputation) Reputation and the effect that specific job will have, and then a greater or lesser work is developed… I will give you an example, auditing a public hospital is completely different from auditing a private company, why? Because the going-concern principle is not at stake, here (public hospital) if you have an insolvency problem, the State puts money here, does not go bankrupt, does not have to borrow, so the auditor's work is directed in another way. In a company it is totally different. In this case, the company is in the market, subject to competition, subject to a set of stakeholders who need to know information about the company's situation; here (public hospital) who needs to know is the State, its shareholder, to know whether it has to put money, if the expense was well done, if it is legal or not. Auditors' work is never the same, it depends on the sector of activity, and within it, it depends on the type of company.

**Interview 3**

1. We have rules of independence in which, to perform our functions, we should be unrelated to everything that incorporates the society we are auditing… Always have an exempt position (…) family ties, not at all, specially, we have rules in our company where we sign a list of clients, and when there is no independence in familiar terms, which happens, people working who have companies with their fathers and do not have independence to do their job in that society, as well as friendships, all ties, that later the company itself (this is my second audit company), and the companies themselves also define their own rules of the concept, usually always integrated into international concepts, we are a small company connected to a concept, we also have to respect all parent company's rules, but essentially, it is exemption, the ability to issue a totally impartial opinion without being influenced by anyone.
2. Typically, a company providing audit services should not provide related services to the same client, such as accounting. It is not the reality of the market, but, usually… For instance, if a society has the two strands, even three strands of consulting, auditing, and accounting, usually, although consulting…. Accounting really is a head-on collision. Consulting, if it is in a specific area… But, as a rule, it should not. It should always be reported or requested an opinion to an external entity that has no ties to the audit firm that is developing the audit service. (What do you think about providing both services?) For example, let's imagine there is restructuring consulting of the client and then any conflict

is detected by the audit, and it was the same company that said to do so. Do you see what I mean? There will be a conflict. Perhaps, the opinion of the same company, the audit opinion will not be impartial. (But, on the other hand, do you think there is any advantage?) Sometimes, yes, it makes our job easier, if there is rigor on the consulting team's part, it is much easier for us when we get there, we know it was that team, it was our company, it will be well done, if it is credible, right? Sometimes it is not like that.

3. Yes, nowadays there are many auditors in the market, there are many audit firms, there is a fierce pricing policy. Now, if you had asked me that question before CMVM entered the audit world I would say yes, now I do not. (Do you think it does not affect independence?) No, because auditors' risks today, or specially who is signing, our risk is to issue a wrong opinion about the accounts and that someone influences us to issue, for instance, a clean opinion when the company has problems. Nowadays, the auditor no longer does that because given the financial scandals we had in Portugal CMVM entered so, it is really bad, they now arrive, especially those who have an entity that provides services (…) public interest entities are companies of huge risk. So CMVM comes in but then it does a horizontal check: it can just be that one and if it finds (…) it gets two or three more that have nothing to do with public interest entities. So, I think nowadays the auditor can, perhaps, that policy, but no auditor just signs, which would happen some years ago. It was a lot about friendship and all and perhaps (…) there were no reservations because he was a friend, nowadays (…)
4. No. I have seen large audit companies' opinions, Big 4, that… In fact, financial scandals were in large companies. As noted, there was no impartiality, no independence. I do not think so. Company's independence also depends on who is in front of the company, who are the partners that manage it, whether they are credible, exempt and professional people, essentially professionals, issue an impartial opinion. Usually, we do (I do not know about

other companies) but, usually, we do interim, intermediate visits to do a small analysis and help the client, alert him. Then if the client does not correct, the risk is his and he takes it, but we will put reservations about those situations. But I will not say we do not try to have a friendly relationship, despite independence, of course, I will not say otherwise. Because if we do not have… we are people always interfering in other's work, annoying activities, asking for things, and without friendship, a chat over coffee, whether it is raining, it has to be to break the ice… But then we have to be professionals at the same time. (In that regard, do you think friendships can be stronger in small companies than in big ones?) Yes, because usually, small companies try to keep the work team, and in big ones those responsible are always responsible but then the team below rotates; and then the resources, while a big entity has several people, one does the assets, another does the fiscal, (…) in small entities, one does everything. So, it ends up by developing more, what does not mean that as an auditor, as a manager of the company and all, that does not exist in big ones, but you know, what I am saying is that it does not reach… Also, usually, big companies belong to big economic groups, so it ends up by not having a connection at all because a lot of people are involved. But yes, small companies have more friendship. (And do you think it can compromise independence?) I do not think so. No, I am auditing a company where the financial director is my boss's former colleague, I mean, deep down, it is that… But my boss is an extremely professional personal, if he has to put a reservation, he puts it, and the financial director also has a good accountant so has no reason to have reservations because things are correct, but there is that one detail. (…) But a professional is a professional. No because, nowadays, the company I belong to has a lot of entities, a lot of hospitals, (…) so it is a risk not to put a reservation or an emphasis on a certain point of the accounts when we know we can be audited by other entities, (…). (So there is another point here, legal exposure) Everything. CMVM fines are around or above 5 thousand, it is a big risk. As the risk is increasingly large, as I was saying, nowadays, with CMVM, independence is not called into question, if you had told me, some years ago, before financial scandals, if you had told, perhaps, there was not so much independence, I would say "if the boss is a client's friend", "see what you can do…", there were last minute calls, we did the work, we prepared things but then someone else would sign it and sometimes they would cut things, because there were calls, there were promises… Nowadays this does not happen, I will be honest, today it really does not happen because there is rigor and what is at stake is a lot of money and prices are not so… There are many auditors in the market and prices are not that high and so they do not put themselves at risk like before. Today the client can say "there are other auditors in the market" but none, only if it is an auditor who… just entered to the market, has no risk… But even the Order it's on top of new companies, new auditors, almost all are audited as early as the first two, three years in which they begin to perform reviewer roles, so today I think more and more the term independence is very strong. Opinion is always put with several, we have just now been validating to public entities budget and investment plans to 2019, it has a lot of warnings because we know, we look, we read something and yet, there is still friendship in the supervisory board, it is independence, we see that it is not well.

5. It is not good, that is why after (at least) seven years it must rotate both the auditor, and the audit team (…) long-lasting friendship relations. But, normally, what I have detected is that the auditor changes, but the team stays, it stays but it changes because the society is made up of more than one reviewer and can even stay the same. In public interest companies it cannot, after a certain time that society leaves, it is required to, has a term after which it has to leave, everyone, nobody stays there for a very long time (…) Although there are rules, there may always be someone who facilitates, but little, I think in big companies and all, where it is more questioned, nowadays is very difficult. (Is there any positive aspect in

keeping the same auditor? Yes (…) if there is exemption and impartiality in the opinion, despite the relationship of friendship, it is good because he client is used to that person, and the person is also accustomed to the client, the way of saying, of driving things forward, than if someone else comes, because we are human, and we all have different personalities, we can work in the same business, but some are ruder than others (…) And we do not have a market, mostly it is small and medium-sized companies where one can get there and say, "I will not but you anything else this month…", claiming. But today rotativity is only questioned in public interest companies, small companies continue with the same auditor for many years, and they will always.

6. It depends on the situation, there are situation where the auditor himself that is the service provider upsets and are dismissed. (But in this case that would not be possible, how would this be either positive or negative?) I think it is negative, because, let's imagine there are conflicts between them, they do not get along, being forced to be there, first, the auditor will be looking for sure for any mistake… There is no good relationship… When there is not… I have just noticed something, I went upstairs to the Financial Direct, or she has a doubt, calls me right away, "How should I account this?" "What procedure should I do?", this does not happen. (So, it would not be good to maintain a good relationship, although, on the other hand, as you said the auditor would pay more attention to all mistakes) Ah, yes. (But, would he be more independent, or not?) I do not know. I do not think so. I think, nowadays, independence is a synonym of professionalism, if a person is independent, is professional, if one is not a good professional anything corrupts. But a professional that looks to… that knows what he has to do, what he has to see, what is at stake, because the risk of a wrong opinion is large, it is our daily risk, is not it? Of not seeing, detecting serious or less serious situations, that should have been reported and were not, that is a risk. Another one is to detect and someone else tells us not to report. Now, if we are professional that

shall be above all else. In my opinion, as I have no cases, I do not know cases in which this was called into questions, other than a few years ago, in the other company, there was an auditor that… yes. (Compromised…) Independence, a little. It was favours. But he should not. Because nowadays (you should not), and one of the companies even went to court, not because of us, but regarding taxation and perhaps if… but we were no longer auditors, we were already out of the market. But has always shocked me that company had no reservations. Why? Because… (Friendship?) I never understood. I do not know if it was… The owner was also a bit crazy, the auditor wanted to keep the customer because he paid well, he wanted to keep the client because he paid very well, on time, of course, when clients are like these we try, is not it? A client who pays on time, owes you nothing, pays a good fee. (But then he faced legal issues) Yes. I think today even business owners themselves are warned that things are different, it can be noted that… (The client?) The customer now also realizes that if they are getting something wrong, they cannot have no reservations, and they are also changing by… Because they also have… Nowadays, the fiscal area is (…) the problem is essentially… there are a lot of frauds in the market. In labour market, small/medium company, what happens, it is always a taxation problem, you see? What do companies want? Not to pay tax authorities. Even state-owned companies do not want to pay taxes. But they know things have to be minimally right and sometimes they even ask the auditor, perhaps for certain situations they can do in a timely manner, it is not to question independence, it is to ask for help in a process, to be the best registered, and also not to be so harmful to the company itself, for instance, a car, today a car in a company, if it is a high capacity car, it is a big cost because besides paying all taxes, then in autonomous taxation that is extremely expensive. And maybe, if you can share in the person’s income in kind, the company will not pay so much, and the person is not that affected. Those suggestions they can ask the auditor, not questioning independence, but having things right with someone's help, but there are things that if they do, the auditor has to be… (You reminded me of a question, reputation) (…) Right now, the company I belong to has at least seven health authorities, hospitals and ARS, why? Because of the good name and reputation the auditor has. (So it is an important factor) Very important, and although his opinions are not clean, they are exempt, we have hospitals with seven or eight reservations and yet his services are requested because besides seeing things we also try to help and warn against problems they themselves want to solve and cannot, they do not know how, because the auditor usually has more knowledge and also because he is auditing other entities that, perhaps, have the (same) problem, business knowledge, we can cover more situations given the insights we already have of others. Especially reputation. That is really important. Very important indeed. (Can it work as an incentive to independence?) Yes, always, because nowadays if it is a good auditor the door opens quicker to be honest. It is not only about money, but about integrity, support and exemption, especially exemption and knowledge.

7. Joint. We have examples of that in which the auditor and the reviewer, it is a joint opinion, because, for instance, the parent company is audited by a group and the subsidiaries are audited by others, and consolidation is done together, we have to issue (…) and usually works well, it does not question independence. (Do you think it helps independence?) It depends, but it helps, the group gets stronger because we have two different opinions. In some situations where the reviewer does not work in a particular area, for example, imagine it is a large group were I review here, and another reviewer does it there and then (…) all reviewers do inventories, and, in my consolidation, I will have inventories that I do not even have, but by what they will tell me of inventories I will form an opinion in parent company without having any inventories, and usually works. And if one says that is all wrong, he is exempt and says that, he knows this one is exempt, and he will put that my affiliate has a problem here and there of the company that I am… But typically there are questionnaires

that are issued to one another to say what it was, so one can see the level of exemption of the one below. There are basic questionnaires sent to one another, typically who consolidates sends them. (But, for example, in this case you would have to split the work) I do not know if that would work out. For example, imagine, it would not work out, I will tell you why… A spin-off of audit firms, I have been through that, where two work policies are joint, two mentalities, two different entities, it did not work, there was a split soon after, one year later, because methods, there are many audit firms in the market, but methods… (But, for instance, in a joint audit, what happens is, there are two auditors, each responsible for his own part, and then they review each other's work and sign together) I have never been through that process, I will tell you my opinion. From the market I know, I do not know a single auditor who speaks well of another auditor's work, I do not see an auditor reading another's opinion and saying, "good job", there is always something there, because he did not see that aspect, because… So I do not believe in joint audits, from where I stand (That would not work) I do not think so. No, not for me, because as I told you, I have the example of a spin-off of another company I was in and that did not work well. (And because auditor's do not say well about each other' work, so here in reviewing, it would not be) Bad. Reviewing an entity's work, for instance, this year we will have to review the work of 2016, done by the previous auditor, they will not simplify this review, they will not give us all the information needed. (When reviewing an auditor's work, do you think you are more independent?) Reviewing a colleague's work? (No, from another company) Yes, it is more independent if I have to review a colleague's work, I will pick up the phone if that is not well done and I will scold him. (And if it is another company?) No, to another company I will not, there it is, among co-workers, but in that case, independence is not at stake. (You will audit a company that has previously been audited by another company, in this case, is there something…) Yes, the correct procedure is, (…), either we trust his work, review it and say the opinion he issued in the previous year was correct, if not, we would only put reservations in some items that, although last year did not have reservations, as we cannot have, e.g., inventories, typically we watch physical counts and if we are not there, we have to put a reservation because we are not present, we do not know if what is there is what should be, we do a sample but from that sample we extrapolate, if we have a certain expected error, extrapolating to a 100% of the universe, we have more, but usually, it works like this. Now if last year's reviewer did not give us access to information, so we can review it, you see. (Do you think there is more caution in this initial phase?) Yes, first because we do not even know the client we want to know, see how it works, audit tests, and then we already know how it works. (But do you think, as it is an initial phase, do you think you depend more on client's opinion or information, and that can have a negative impact?) Yes, it depends a lot on the information the client gives us. (And can it be negative to…) Yes, because, we will end up concluding that maybe what the client said to us was not right; that is why when I am with my assistants, the first thing I say to them is, in auditing the first thing we have to do is to check procedures, is to do an analytical review, see how the accounts are. And an analytical review is only done with a balance sheet, with an income statement, with the person in charge to explain the variations. Then when we start doing substantive testing, controls testing and all, we will see and detect that perhaps that evaluation was not quite like that. And from there we start seeing with the client, we start analysing him, if he is honest, because sometimes he is not, and does not give us what he should. (But this whole process is still in time for the report) Yes. We always try to do interims, not just to close accounts, when there is no time to solve anything. (And if you compare a first report with a second one, you already know…) Yes, yes, we already know more about the area, the weaknesses, were to interfere… A first report is always a discovery, see what was wrong last year and try to see if really was so. The first year is always a bit more difficult because we have to know people, we have to know the process, how it works and all, is more in-depth. Then, as the years go by, there is always control testing to do, but it is already different from first year's auditing, in any client, a first year is much more laborious. (But do you think it can call into question…) No, no. I think independence, in auditing, especially in the first year is not called into question. (Do you think report users can rely on it?) Yes, I think so, in my view when we issue a report, it has to be correct because it is going to be used not only by administration, but also by other entities that will read it, and if we are issuing one (of those reports) … It is not advisable.

8. It depends, because when companies are not ok no matter how much we do not want to, we get a little involved, of course the healthier the company, the better, the better the environment, it does not mean independence, or that I will not put reservations because… Is that human side working but independence is not at stake because we will have to say the company will not pull through. Today independence is not at issue almost nowhere, at least in companies I am present, I have never been in a small society, although not a Big 4, are entities with rules, very specific rules about independence, we have handbooks, a lot to fill that always question independence… Offers, all of that has a manual, we can only accept it up to a certain amount, if it is exceeded, we have to report to an auditor who, a partner, to know that that client is giving us an offer above… At bottom all team is being corrupted.

**Interview 4**

1. Being independent in auditing is to basically give an independent opinion, that is, to carry out audit work so to issue an independent opinion about company's accounts and to be sure numbers are in accordance, represent the company's financial reality to an external entity.
2. Yes, I think so. If there is a material misstatement due to professional incompetence, to a poorly provided service, there may be a tendency to protect, since it is the same company, independence may be called into question, yes. (On the other hand, do you think is there

any advantage in the simultaneous provision of these services?) Depends on the services, for instance, I think fiscal and taxation, because it is a financial audit, not a fiscal audit, that is, I think fiscal can really have advantages, meaning, I think it is more independent, it can be more independent and can get advantages from the work we have done for a greater knowledge of all company's actions, so I would say in terms of fiscal consulting, yes, and even processes, it also can be, because processes matter in final but not directly, so I would say process optimization and fiscal, I think so.

3. In terms of independence, no. It can affect work quality, but not independence. No. The competition problem is the first audit works and first teams, but there is always a very strong message to do a quality job, and not facilitate, because there is also a maximum number of years to rotate and all, so I do not think so. (In terms of quality, can you specify it a little more?) Audit company's tendency, year after year, is to start gaining more confidence as they spend more time in a client. As such, teams' knowledge level reduces, many times the teams reduce so to (choose) budget, that is, to competition, so there is a tendency to have more junior staff doing clients, which perhaps was previously done by senior staff, and that can be reflected in quality and in critical sense of looking at values. You always have to do everything for this not to happen, but it is a risk.
4. Comparing to small companies? This is by feeling and not by the full knowledge of facts, but I would say yes, I think smaller companies are more prone to, perhaps, try to protect their position. I think small companies tend to be less independent. (Why do you think so?) It is a feeling, it is just because, as the market revolves a lot around Big 4, I think, and even by clients (…) by small companies, either was another kind of… That is, I have noticed that clients who have had small companies were more error-prone, i.e., perhaps there was more easily an error. Maybe sometimes, by wanting to keep the client and all, the work itself may not be done with quality or even independently. Because a large (company) has a larger

portfolio of clients to manage. (Do you think the client is more important to the small audit company than to…?) Yes, there is more dependency, yes.

5. I think there is eight-year rotation, I am against being able to only rotate the partner and not the company, I think it should be mandatory to rotate the company. (That is, you are in favour of auditors' rotation) I am, I am in favour of rotation and I think it should be done differently because the same company can be kept, for example, the company says that changes the partner, and I do not agree with that, I think it should be mandatory to change the company, partners are right next to each other. (Can you explain a little more why do you agree?) I think the reason to change a company or a partner is really not to allow repetitive errors and bring a new perspective, and even if there is a lack of independence, break with that lack of independence, i.e., given there is an option to only change the partner, which can be from the same company, partners are in the same meetings, they often share teams, that is, it can be the person next to you, so I think a simple change of partner will not be able to mitigate all those risks. (Is there any positive side about repetition?) Yes, during maybe up to three years, yes, up to three years the same person, because then teams also change, I would say two years, because then you start getting a little addicted, but two, three years a person gains experience, so also improves critical approach, I speak from experience. That is, you will get to better know the business, because the auditor has that problem, is an outsider, so his business knowledge is not as much as that of the people working there, so is a knowledge that evolves, so I would say two or three years is important, perhaps from the third year on the propensity starts to be more to addiction than to continue to increase client's knowledge.
6. I think so (it can have advantages), I think so, without a doubt. Just as I think turnover is advantageous, retention is also good because, taking the example I gave, the client who used to work with a small auditor that did not persisted much with certain aspects, suddenly gets

a big company with greater experience, or another kind of tests, whatever the reason, that starts to find some errors. That can never be a reason to change, i.e., I think to guarantee service's quality and that the reason to change is a proper reason and not simply because the auditor is being much more annoying than the other, I think it is good to have retention.

7. I think it brings neither gains nor losses. I have already done it, I do not think… It brings two viewpoints, of course, perhaps you can also gain a little, there is that propensity to want to show work but in terms of independence I would say no more, no less.
8. I want to believe, and I believe that there is no relationship. (What if it is between the likelihood of facing legal issues and the auditor's ability to remain independent?) I think that if there are legal issues, the ability to remain independent is even greater, I think it increases, because the auditor's risk is higher, the auditor has his company's name and his own to defend. When there is legal risk, because usually the auditor is not faced with many legal risks, he is more with financial risks, i.e., I think in that case independence increases, I think it will increase, given the risk of fraud and all. Fortunately, I was not confronted many times, but from the experiences I had I can say I was much more alert.

**Interview 5**

1. It means not to adjust auditing to the client, to client's or business's difficulties, and distract from, not to circumvent any of these.
2. It can. (How do you think it can affect?) Because you can take as granted something that is not. (Can you explain it?) For example, consulting can assemble some processes and just because it is the same company to assemble those it does not mean they are right. Sometimes they do not look at it and auditing should. (On the other hand, do you think there are advantages arising from the provision of both services?) Ah, there are advantages, yes, to the audit company, to the firm that is providing the service because it may already know the business, know the client, and facilitate, it is easier to gain efficiencies.

3. Yes, as we had just spoken, about circumventing or turning a blind eye to something, competition also can, is not it? Competition wants to enter, and the client is not happy with the year’s audit. The auditor may turn a blind eye to something so that the client does not change to competition… Sometimes even the client may want to change to competition, so that competition turns a blind eye to certain situations.
4. Larger firms are more independent, yes. (Why do you think is that?) Because small companies are more dependent while large companies are not, small companies can lose an important client and perhaps will not want to lose due to issues related to the opinion issuance… Can lead them to circumventing some situations so not to lose the client. (So, do you think the client is more important to small companies than to large companies?) Yes, exactly.
5. I think rotation should be mandatory. (What do you think rotation could mitigate?) The method of looking at things, sometimes it is such a (diffused) situation and you do not apply another method of evaluating information, and another company may have a different methodology and can detect, is not it? Because one has no obligation to detect, but if detected, has the obligation to disclose that situation, and, changing the methodology, changing the tests, all new, more is uncovered (…) (On the other hand, is there any advantage in being with the same client for a few years?) I think it has advantages, but to the client.
6. I think it is indifferent.
7. Independence would improve. I think there would be greater independence, it would not be confined to methodologies from the same company, but rather (from those available).
8. I do not think it exists. I think it would not change, the person is not obliged to find, but if you find, you are obliged to divulge, if I find and not divulge it is serious, and then I cease

to be independent, but if it does not have any variation, neither I stop being independent nor I become more independent.

**Interview 6**

1. Being independent is not having interests in the entities we audit, i.e., for which we provide audit services, and interests can be monetary interests, can be personal, can be knowing someone in core functions in those entities, for instance, the financial director, my wife, or my uncle, or my father, my mother. And then independence has two sides, that independence (…) independence in appearance, that is not to accept any kind of reward, of gift from entities. Although often immaterial, outsiders' idea may not be so, and we should ensure people see us as independent of institutions. Usually having lunch with clients when we are there auditing them is (not) normal, on a weekend a client invites us to spend the weekend with him, is not, or invites us to have dinner with his family, we may be getting a little too close to the question of independence, more in a concept for the exterior than for the interior.
2. At the moment, considering (sales), it hardly influences, because in Portugal, the maximum that can be provided of services is, normally, 30% in relation to audit services, as such, 30% has no influence. In the past, when I could have a client in which auditing was 20 thousand and consulting was 200 thousand there could be more of a pressure, it is more a matter of pressure than calling independence into question because, of course, there is always more pressure when we depend on a non-audit remuneration, but with 2016's new rules I think that was more or less solved, and it is not allowed in listed companies (…) more than 30% (…) so, it was applied to more or less ensure, exactly that kind of…
3. Not independence. It can affect is, if they enter into a price war is bad, because it is not possible in face of new audit requirements, new standards, a series of additional procedures that have to be done, which in recent years have been added by regulators, it is not possible

to carry out a good quality audit in (several) proposals constantly when following a tender, there is a 40%, 50% reduction in the previous price, it destroys the market and the quality to client. It is not about independence itself, they are always independent, it is much more about rotation, rotation is good but every time there is a (…) there is a 30% fall (…) unusual, that I do not believe, or to maintain services quality we have to keep (…) or others we had from the past. (How would quality be at stake?) The involvement of so many people, of so many resources, with more experience, engagements are also internally evaluated for their (loyalty), when estimating budget the goal is to have a positive result in that engagement, if we do not have, if (…) it does not bear to involve people that we should involve, is bad, internally, as far as I am aware of, when there are those situations the client is not accepted, when we are not able to do a job with the quality we should, either (…) increases, or there is no proposal.

4. No, that is not the point. We have rules, I think the only difference is, compliance is the same because the rules are the same, the only difference is that we, besides the external monitoring that we have in Portugal, CMVM and OROC, we have our internal which is as, or more demanding than CMVM or OROC and therefore, we are annually subject to internal quality control that evaluates those situations.
5. It has advantages and disadvantages. When rotation was discussed, and it was discussed some years ago, when there were cases of United States, of Enron and WorldCom, so in United States rotation has not yet been adopted, they are considering, at the time rotation was considered when Parmalat took place in Italy. Italy has rotation for more than thirty years, so even though there was rotation, fraud still prevailed in that entity, for instance, on the one hand, rotation is good because they are new faces, we already had rotation internally, in the past, rotation worked so that the partner had to rotate at the end of a certain time, so regardless of not rotating the auditor, at least the partner rotated, and who entered had no

knowledge of that client (…). With audit firm rotation there is an additional cost to both auditors and companies, because companies will have to explain everything again when a new auditor comes, and the new auditor is always, in the first, second years, in very large institutions, a big investment, so, the auditor is assigned to a client without knowing anything… Without knowing anything… Knows public information, but does not know anything else. (Do you think in the first years auditors depend very much on the information the company provides to them?) In every year, every year depends a lot on the information that is obtained from the company, what happens is that in the first year everything is new, in the second year we have a basis and we update the basis in the face of possible changes that may have existed in the entity. (What would be the negative side in preserving the same auditor?) Here is to avoid a matter of "getting used to it", fresh eyes are (in)different of a person who is there for five or six years.

6. It is somewhat indifferent. At the moment, it can have three mandates, so it can be up to seven years or ten, if there are more mandates, but there are other countries, so Germany can go up to twenty, it depends on what countries adopt in terms of minimums or of maximums allowed in standards.
7. There is no great advantage, they will not be doing the same thing, they will end up dividing tasks, so, in France there is already joint audits and has not had, I think it has not had that great of an improvement of independence by having joint audits, is the only country I know from Europe that has joint audits. I think that measure was kind of the question (…) of clients as of auditors do not have, it is difficult to implement. (So, by doing different tasks it ends up by not bringing significant benefits, right?) Parmalat case happened exactly because there were several auditors involved, so the communication between them was not fantastic. When we have large groups in which some are here, and others are there,

communication turns out not to be as good as if it was always the same auditor, the same company.

8. There is an independence that is, we cannot resume a work the following year until we are paid the fees of the previous year, so, we have clients that do not have the ability to pay (…) limiting our performance in the second year and the acceptance of another auditor because even if auditors change, we always have to communicate (to the previous one) if there is any situation that (…) (If there is greater exposure to legal issues, do you think it will impact independence?) No, not in Portugal, in Portugal I am not aware of having been called into question so far, in terms of courts, any question related to auditors' independence, as far as I know. In other countries yes, Brazil, one of the Big 4 was fined 10 million because of the very close relationship of the auditor with the CFO, so there are situations like this, but in Portugal I am not aware that there is, but anyway we have our internal mechanisms to mitigate that this can happen.